AUDIT REPORT

AUDIT OF THE

ASSESSMENT PROCESS

WITHIN THE DOF

(Audit Report No. 96-044)

OFFICE OF THE INSPECTOR GENERAL
FEDERAL DEPOSIT INSURANCE CORPORATION

May 20, 1996

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FDIC ASSESSMENT PROCESS WITHIN THE DOF

Table of Contents

Federal Deposit Insurance Corporation
Washington, D.C. 20429 Office of Inspector General

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DETAILED AUDIT REPORT
OFFICIAL AUDIT RELEASE

MEMORANDUM TO: Steve W. Black, Deputy Director
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SUBJECT: Audit of the FDIC Assessment Process Within the DOF
(Audit Report No. 96-044)

INTRODUCTION

The Office of Inspector General (OIG) performed an audit of the FDIC assessment process within the Division of Finance (DOF) to evaluate the adequacy of the methods and controls, and the reasonableness of billing, collecting and recording assessments. We also evaluated the accuracy and completeness of the assessments billed, recorded and collected. The audit included the July and October 1995 quarterly assessment activity which totalled approximately $2.5 billion, as well as the September 1995 bank insurance fund (BIF) refund which totalled $1.5 billion.

The FDIC is commended for the development and implementation of a risk based assessment approach which meets the requirements of the FDIC Improvement Act. The Division of Supervision (DOS) developed a risk based system that classifies institutions based upon the risk of loss they represent to the respective insurance fund. The DOF developed and implemented automated systems for calculating, billing, collecting and recording assessments that was in use for the July 1995 assessment period. Based on our audit tests, the DOF appropriately calculated, billed, collected and recorded approximately 24,605 assessment transactions totalling $2.5 billion for the July and October 1995 quarterly assessment activity; and, properly calculated and recorded the September 1995 BIF refund totalling $1.5 billion.

We recognize that the FDIC continues to enhance its controls over the assessment process and its operations. The OIG has identified the following items which further improve the assessment process:

- Coordinate the reviews of institutions without Risk Related Premium System rating classifications in order to limit the use of Assessment Information Management System (AIMS) default rates.

- Separate the invoice processing function from the Automated Clearing House (ACH) data file maintenance function to provide additional protection of assets against misuse, fraud, or embezzlement.

- Limit the users who can create or edit data in the AIMS to Assessment Operations personnel in order to prevent errors and to provide additional protection of assets against misuse, fraud, or embezzlement.

- Conduct background investigations on personnel handling sensitive assessment information.

- Document the DOF verification that AIMS contains the complete universe of insured institutions.

- Assign risk classifications to institutions by using examination reports as of the established dates to ensure equitable assessments of institutions.

- Require written approvals of invoice summary reports and related adjustments to support assessment accounts receivables.

BACKGROUND

The FDIC assesses bank and thrift member institutions premiums for their insurance coverage. The members include institutions for which the FDIC is the primary federal regulator, and institutions for which FDIC is the secondary federal regulator. When FDIC is the secondary federal supervisor, the primary federal regulators may include the Federal Reserve System, Office of the Comptroller of the Currency, and Office of Thrift Supervision.

As required by the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989, the FDIC maintains and accounts for bank and thrift member institution assessments separately. Bank assessments are accounted for in the Bank Insurance Fund (BIF), while the thrift assessments are accounted for in the Savings Association Insurance Fund (SAIF). Assessments provided 71% and 85% of the BIF and SAIF revenue respectively for the calendar year ended 1995. For the July 1995 quarterly assessment period, 12,318 institutions paid approximately $1.36 billion to BIF and $428 million to SAIF for a total of $1.79 billion in assessments. During the October 1995 quarterly assessment period, 12,287 institutions paid approximately $261 million to BIF and $431 million to SAIF for a total of $692 million in assessments. The FDIC refunded $1.5 billion to BIF institutions on September 15, 1995 because BIF was recapitalized as of May 31, 1995.

Significant changes have occurred in the assessment process regarding the rates charged institutions and the methods and systems used for calculating, billing, collecting and recording assessments. Prior to January 1, 1993, institutions were assessed at a single rate of 23 cents per $100 of insured deposits, and the institutions calculated and submitted their assessments to the FDIC semiannually. In calendar year 1993, FDIC implemented a transitory risked based assessment system whereby institutions were assessed between 23 and 31 cents per $100 of insured deposits. In accordance with the FDIC Improvement Act of 1991, on January 1, 1994, the FDIC implemented a permanent risk-related assessment system that classifies and assesses institutions based upon the risk of loss they represent to their respective insurance fund. Assessments were received by lockbox banks.

Commencing with the July 1995 quarterly assessment period, the FDIC implemented a new billing and collecting process and system. Although assessments are based on a semiannual period, assessments are now calculated and billed by the FDIC quarterly. Assessments are received through an Automated Clearing House direct debit process which allows the FDIC to electronically retrieve funds directly from institutions' accounts. Assessments are electronically deposited into the FDIC U.S. Treasury account.
As a result of the recapitalization of the BIF in May 1995, the FDIC Board of Directors approved a retroactive reduction in assessment rates for BIF members to a range from 4 to 31 cents per $100 of insured deposits resulting in a refund of $1.5 billion. Effective January 1996, the FDIC Board of Directors approved a rate structure whereby the highest rated institutions will pay the statutory annual minimum of $2,000 and the remaining BIF members will pay a range from 3 to 27 cents per $100 of insured deposits. SAIF members will continue to be assessed a range from 23 to 31 cents per $100 of insured deposits.

The Division of Supervision (DOS) maintains Structure, a data base containing FDIC's official record of institutions. The DOS also assigns assessment risk classifications to insured institutions using the Risk Related Premium System (RRPS). The RRPS accesses the institution universe from Structure, Reports of Condition from the Call and CallSL systems, and supervisory examination results from the Summary Analysis of Examination Reports (SAER) system to create risk classifications. The Division of Research and Statistics evaluates the assessment rates every six months based on the BIF and SAIF reserve ratios and, when necessary, recommends rate adjustments to the FDIC Board of Directors.

The Assessment Operations Section (AOS) within the DOF is responsible for preparing and submitting assessment invoices to insured member institutions. The AOS uses the

Assessment Information Management System (AIMS), a mainframe application developed by the Division of Information Resources Management (DIRM), to calculate and prepare the assessment invoices. The AIMS interfaces with Structure, Call, CallSL and RRPS to obtain the universe of institutions to be assessed, their assessment base, and their related risk classifications. Using this information and the assessment rate schedule, the AIMS calculates the assessment amount and generates an invoice. Invoices are submitted to each institution 30 days prior to the quarterly assessment period. The AIMS also creates an obligation file which is electronically sent to the Accounts Receivable Unit to establish receivables for each institution. Prior to the payment date, the AOS uses AIMS to create an Automated Clearing House (ACH) file containing each institution's invoice routing and account numbers. The ACH file is used by the Cash Management Unit to electronically collect or refund assessments from each insured institution. At the same time, AIMS creates a payment file which is electronically sent to Account Receivable Unit to relieve each institution's account receivable obligation.

The Account Receivable Unit (ARU) within DOF is responsible for recording assessment receivables. The ARU uses the Corporate Accounts Receivable Management System (CARMS) to interface with an AIMS obligation file to electronically record assessment receivables, and with an AIMS payment file to electronically record assessment receipts. Assessment receivables are recorded at the time of invoice, approximately thirty days prior to the payment due date. Assessment receipts are recorded on the day before payment is due because most payments are received on the due date. Reversal entries are made in CARMS for payments not received from institutions. The CARMS data is transmitted to the general ledger (GL) during an overnight interface.

The Cash Management Unit (CMU) within DOF is responsible for collecting and recording assessments received. The CMU, using the ACH file provided by AOS, collects assessments through the ACH direct debit process which allows the FDIC to electronically remove funds from the institutions' accounts through the Federal Reserve of Richmond. The assessments received are then electronically transmitted to the FDIC U.S. Treasury account. After receiving confirmation from the Federal Reserve of the total dollar amounts, accounts debited and number of transactions processed, the CMU manually prepares the journal entries by fund, along with a spreadsheet of transactions transmitted for payment minus those rejected and those paid by wire transfers and checks. The assessments received are totalled manually and recorded by fund in the Cash Management System (CMS) and the GL on the day received.

A flowchart of the assessment process is presented in Exhibit 2.
A glossary of terms is presented in Exhibit 3.

SCOPE AND OBJECTIVES

The scope of the audit included the policies, practices, procedures and systems used by the DOF to process assessments during the July and October 1995 quarterly assessment activity and the September 1995 refund. The objectives of the audit were to evaluate the adequacy of the methods and controls, and the reasonableness of the processes used for billing, recording and collecting assessments. We also evaluated the assessments billed, recorded and collected.

AUDIT CONCLUSIONS

For the July 1995 semiannual assessment period, the FDIC implemented adequate methods, controls, and processes that, in all material aspects, properly produced 24,605 assessment invoices, and accurately recorded and collected $2.5 billion in assessments. Our conclusions for each objective are summarized as follows and a more detailed discussion of each item is presented under the CONDITIONS AND RECOMMENDATIONS section of the report.

Internal Controls Over Assessments

Based on our audit, the methods, controls, and processes used for billing, recording and collecting assessments are considered to be adequate and reasonable. However, improvements can be made to ensure that all institutions receive the most current risk classifications and controls over data access can be enhanced. In addition, recommendations are made for obtaining background investigations for personnel who handle assessment information; and for establishing procedures to ensure the consistent application of criteria used for institution risk classifications. A summary of the items to further improve the assessment process include:

- Improvement is needed in coordinating the reviews of institutions which have been assigned default risk classifications to ensure that the most current risk classifications are assigned to institutions before assessment invoices are generated. During the August 1995 invoice production, 16 institutions were classified using the default risk classifications. The use of the default risk classifications resulted in over assessments of approximately $94,327. The DOF refunded $30,303 to 13 institutions. However, $64,024 was not refunded to three institutions. DOF replied that there was an early cut-off for the August 1995 invoice production due to the urgency of the BIF refund caused by the BIF recapitalization. In addition, to reduce reconciling items, DOF requested that DOS not update the RRPS during the period that AIMS produced invoices. The three institutions, requiring a refund of $64,024, are included in DOF's list of items that need to be resolved. Effective and efficient coordination of the DOF and DOS reviews of institutions with default risk classifications will ensure that institutions have the most current risk classifications, and limit the need to refund assessments and make adjusting entries. Within the established timeframes, the DOF and DOS have agreed to more closely coordinate the reviews of risk classification prior to issuing assessment invoices. Additionally, the DOF indicated that it has refunded $62,480 to two acquiring institutions and is conducting research to determine the appropriate action for the remaining $1,544.

- To enhance controls over the assessment process, the invoice processing function needs to be separated from the ACH data file maintenance function. The AOS uses AIMS to calculate the amount of the institutions' assessment. The AOS also creates and maintains the ACH data file which contains the account and routing numbers used to direct assessment payments and refunds through the ACH system. The separation of these duties will provide additional protection of assets against misuse, fraud, or embezzlement. It is recommended that DOF reconsider the placement of the function for maintaining the ACH data file from the AOS to an appropriate office or unit that does not generate or record payable or receivable transactions. The DOF responded that the recommendation will be considered as part of the overall internal review of AIMS to improve controls over the ACH data.

- The ability to create or edit AIMS transactions needs to be limited to the AOS. Three DIRM programmers have the ability to access AIMS and make changes to assessment data. The ability of individuals outside of AOS to create or edit AIMS data could result in assessment data being changed intentionally or inadvertently as well as create the opportunities for the embezzlement of funds. Effective internal controls include the separation of programmers from the production environment. Therefore, it is recommended that DOF request DIRM to modify the security designations so as to limit the users who can create or edit assessment data in AIMS to the Assessment Operations personnel. The DOF responded that it will meet with the DIRM to implement appropriate access to AIMS, and expects action to occur by June 21, 1996.

- The FDIC personnel handling assessment information need background investigations to ensure that sensitive information is not disclosed or manipulated. Federal law and regulations require that federal agencies maintain an effective Personnel Security and Suitability Program. However, the DOA has not verified the sensitivity designations or performed background investigations of personnel involved in the assessment process which includes the use of sensitive information such as institutions' risk classifications, account and routing numbers, as well as the billing and collections of funds. DOA representatives informed the OIG that most FDIC personnel have not received background investigations because of the FDIC reorganization, downsizing, National Treasury Employees Union (NTEU) negotiations, and lack of detail position descriptions. It is recommended that DOA determine the reasonableness of designations of DOF positions and perform the appropriate background investigations on personnel involved in the processing of the assessment process. The DOA Security Services Section responded that it has developed an action plan to complete suitability background investigations on high risk positions first and then moderate and low risk positions.
- The DOS needs to ensure that risk classifications are consistently assigned to institutions using examination reports available as of the established dates. The DOS Director instructed the Regional Directors to use SAER data for examinations <u>transmitted</u> to the institutions as of established dates, while other primary federal regulators were instructed to provide the FDIC with tapes containing classifications

using data available as of the same established dates. In addition, the DOS' RRPS is programmed to extract the examination results from the SAER database for examinations with reviews completed, but not necessarily transmitted, as of the date that RRPS interfaces with the SAER database. Our analysis of the institutions classified for the semiannual period beginning July 1995 determined that 357 FDIC regulated institutions received risk classifications based on SAER data reviewed and transmitted after the established date. Although not classified in compliance with the DOS Director's instructions, the FDIC regulated institutions were classified using examinations available in the Regional Offices as of the established date. Consequently, all institutions regulated by the FDIC and the other primary federal regulators were consistently classified using data available as of the established date for this assessment period. However, controls are needed to ensure that risk classifications are consistently assigned in future assessment periods. Therefore, it is recommended that DOS inform the Regional Offices that risk classifications assigned by the RRPS should be based on examinations received by the established dates and reviewed by the RRPS and SAER interface date. The DOS agreed to implement the OIG recommendations.

Billing, Recording and Collecting Assessments

Assessments billed, recorded and collected are reasonable in all material respects, based on tests performed of transactions sampled. Assessment invoices that we reviewed are complete and calculated accurately in all material respects. Likewise, based upon our testing, assessment receivable and receipt journal entries were recorded properly in the CARMS and transmitted to the general ledger. Assessments collected were received and recorded properly in the cash management system, general ledger, and the FDIC U.S. Treasury account.

FDIC management's response to the draft report indicated that $62,480 has been refunded and that research is being performed to determine the appropriate action for the remaining $1,544.

EXECUTIVE ACTION REQUIRED

No executive action is required because the responsible managing officials agree with the recommendations, and has indicated in their response that corrective action has been taken or is being implemented to address the items identified in the CONDITIONS AND RECOMMENDATIONS section of this report.

AUDIT PROCEDURES

Audit procedures and techniques used to achieve the audit objectives included:

- Reviewing the related FDIC Directives, Circulars, Policies and Manuals and Federal laws and regulations;

- Discussions and visits with FDIC personnel to determine policies and procedures for billing, recording and collecting assessments;

- Verifying that the correct call systems data was used in AIMS and RRPS;

- Evaluating the controls and testing the assessment universe;

- Recalculating the assessments for a sample of institutions;

- Evaluating the controls and testing the authorization and accuracy of the files transmitted from AIMS to CARMS and then from CARMS to the GL;

- Determining whether manual adjustments to CARMS are properly supported and authorized;

- Evaluating the controls and testing the authorization and accuracy of assessments processed through the ACH direct debit payment as well as other payment methods;

- Verifying the deposit of assessments into the FDIC U.S. Treasury account;

- Evaluating the resolution of outstanding assessment receivables;

- Evaluating the controls and testing the authorization and accuracy of assessments recorded in the CMS and GL;

- Evaluating the controls and testing the accuracy of reconciliations and resolution of differences;

- Evaluating the retention of records policy;

- Evaluating the security of the AIMS and CARMS; and,

- Other audit procedures necessary to accomplish the audit objectives.

The audit was conducted in accordance with generally accepted government auditing standards. Accordingly, such audit tests and procedures deemed necessary were performed.

CONDITIONS AND RECOMMENDATIONS

I. Coordinating Default Risk Classifications

CONDITION: Improvement is needed in coordinating the reviews of institutions which have been assigned default risk classifications to ensure that the most current risk classifications are assigned to institutions before assessment invoices are generated. During the August 1995 invoice production, 16 institutions were classified using the default risk classifications. The use of the default risk classifications resulted in over assessments of approximately $94,327. The DOF refunded $30,303 to 13 institutions. However, $64,024 has not been refunded to three institutions. DOF replied that there was an early cut-off for the August 1995 invoice production due to the urgency of the BIF refund caused by the BIF recapitalization. In addition, to reduce reconciling items, DOF requested that DOS not update the RRPS during the period that AIMS produced invoices. The three institutions, requiring a refund of $64,024, are included in DOF's list of items that need to be resolved. Effective and efficient coordination of the DOF and DOS reviews of institutions with default risk classifications will ensure that institutions have the most current risk classifications, and limit the need to refund assessments and make adjusting entries.

For each semiannual assessment period, the DOS' Risk Related Premium System (RRPS) classifies insured institutions into one of nine risk classifications using supervisory examination reports issued by primary federal regulators and financial information filed by the institutions. The risk classifications range from 1A to 3C, with 1A being the best class. It is DOS' policy to assign a 1A classification to new institutions unless specific circumstances indicate a lower classification is warranted. The classifications for a semiannual period are not changed unless an institution has a successful appeal of a classification or retroactively amends its financial information based on subsequent data.

At the beginning of the quarterly assessment invoicing process, the AOS interfaces the Assessment Invoicing and Management System (AIMS) with the RRPS to obtain the risk classifications for each institution. The AIMS generates an assessment invoice based on the applicable rate for the institution's risk classification. In accordance with FDIC regulation Section 327.4(b), AIMS "assigns 2A classifications to institutions for which rate classifications cannot be determined as of the invoice date." Based on the audit tests performed, AIMS successfully interfaced with RRPS and properly assigned default classifications to 16 institutions for which RRPS had no ratings. However, based on our interviews, the coordination between DOF and DOS after the AIMS and RRPS interface would have resulted in 1A classifications assigned to the institutions.

During the August 1995 invoice production, 14 new institutions were not classified 1A by RRPS. In addition, RRPS did not contain the classifications for two terminated institutions because the institutions terminated during the first quarter of the semiannual period. The two terminated institutions had been classified as 1A for the entire semiannual period. Since there was no formal policy requiring the coordination of DOF and DOS to review the institutions without classifications, the sixteen institutions were classified as 2A by AIMS. One of the 14 new institutions subsequently terminated, the remaining 13 were classified as 1A and refunds totalling $29,913.68 plus interest of $389.30 were made by AIMS for the thirteen remaining institutions. However, adjustments totalling $64,023.56 in refunds were not made to the three terminated institutions. DOF replied that the three institutions requiring a refund of $64,024 are included in their list of items that need to be resolved. See EXHIBIT 1.

RECOMMENDATION: To the degree that no delay will result in producing invoices, DOF and DOS should coordinate the resolution of issues involving institutions given a default classification by AIMS prior to mailing invoices to the institutions. To provide for a more effective and efficient assessment process with limited subsequent adjustments, the OIG recommends:

1) The DOF and DOS coordinate the reviews of institutions which have been assigned default risk classifications prior to issuing assessment invoices.

2) The DOF refund $64,023.56 to the acquirers of the three terminated institutions and make the appropriate adjustments in the FDIC accounting records. See EXHIBIT 1.

* * * AUDITEE RESPONSE * * *

DOF: The Chief, Assessment Operations Section, has taken steps to ensure that the "final" processing of invoices does not occur without E-mail documentation from DOS that all risk classifications have been assigned to the extent possible. Because of the postmark deadlines and other priorities, "final" processing must occur within established timeframes.

The Assessment Operations Section has refunded two acquirers and provided appropriate accounting data relative to adjustments in CARMS and the General Ledger. The third potential refund is being researched to determine appropriate action.

DOS: DOS agrees to coordinate with DOF the reviews of institutions which have been assigned default risk classifications prior to issuing assessment invoices.

* * * OIG COMMENTS * * *

The OIG recognizes the efforts made by DOF and DOS to ensure that institutions receive the most current risk classification prior to issuing assessment invoices in light of established timeframes.

II. **Enhancing Controls Over Assessment Data Files**

CONDITION: To enhance controls over the assessment process, the invoice processing function needs to be separated from the Automated Clearing House (ACH) data file maintenance function. The AOS uses Assessment Information Management System (AIMS) to calculate the amount of the institutions' assessment. The AOS also creates and maintains the ACH data file which contains the account and routing numbers used to direct assessment payments and refunds through the ACH system. The separation of these duties will provide additional protection of assets against misuse, fraud, or embezzlement.

AOS uses AIMS to generate the assessment invoice amount to be paid by or refunded to institutions electronically through the ACH. AOS also creates and maintains the ACH data file which identifies the institutions making assessment payments or receiving refunds. The ACH data file contains sensitive institution information, such as the institution's account and ACH routing numbers. The individuals having the ability to determine the amount of assessment payments and refunds could direct assessment refunds to themselves. Effective internal controls include a separation of duties between the billing and ACH data file maintenance functions.

RECOMMENDATION: To provide additional controls over the assessment process, the OIG recommends that DOF reconsider the placement of the function for maintaining the ACH data file from AOS to an appropriate office or unit that does not generate or record payable or receivable transactions.

* * * AUDITEE RESPONSE * * *

As part of an overall internal review of AIMS, the Internal Review Branch and Assessment Operations Section will review the OIG recommendation and recommend to the Director, Division of Finance, a course of action to improve controls over the ACH data.

* * * OIG COMMENTS * * *

Separating the responsibilities of individuals having the ability to create and direct assessment payments and refunds will provide additional protection of assets against misuse, fraud, or embezzlement.

III. **Limiting Access to the Assessment Information Management System**

CONDITION: The ability to create or edit AIMS transactions needs to be limited to the AOS. Three DIRM programmers have the ability to access AIMS and make changes to assessment data. The ability of individuals outside of AOS to create or edit AIMS data could result in assessment data being changed intentionally or inadvertently as well as create the opportunities for the embezzlement of funds. Effective internal controls include the separation of programmers from the production environment.

Transactions such as updating the rate schedule, inquiry of an invoice amount, or adding an ACH account, are defined within AIMS. The mainframe security software Access Control Facility 2 (ACF2) provides internal system security for the AIMS by allowing only designated personnel to perform certain defined transactions. We determined that the ACF2 security designations for AIMS included three DIRM programmers who had access to create or edit data such as the assessment rate schedule, ACH accounts, and direct debit exemptions. The ability of individuals outside of AOS to create or edit AIMS data could result in assessment date being changed intentionally or inadvertently as well as create the opportunities for the embezzlement of funds.

RECOMMENDATION: To maintain effective system controls, the OIG recommends that DOF request DIRM to modify the ACF2 security designations so as to limit the users who can create or edit data in AIMS to Assessment Operations personnel.

* * * AUDITEE RESPONSE * * *

AOS will meet with Financial Information and Requirements Branch (FIRB) to review access pertinent to the creation and editing of data in AIMS and to determine (limit) the number of users who should have this access. AOS will then meet with DIRM to implement appropriate access. Action will occur by June 21, 1996.

* * * OIG COMMENTS * * *

The OIG concurs with actions planned by DOF to determine (limit) the users needed to create and edit AIMS data.

IV. Performing Background Investigations

CONDITION: The FDIC personnel handling assessment information need background investigations to ensure that sensitive information is not disclosed or manipulated. Federal law and regulations require that federal agencies maintain an effective Personnel Security and Suitability Program. However, the DOA has not verified the sensitivity designations or performed background investigations of personnel involved in the assessment process which includes the use of sensitive information such as institutions' risk classifications, account and routing numbers, as well as the billing and collections of funds. DOA representatives informed the OIG that most FDIC personnel have not received background investigations because of the FDIC reorganization, downsizing, National Treasury Employees Union (NTEU) negotiations, and lack of detail position descriptions.

Federal agencies were mandated under Executive Order 10450, dated April 27, 1953, to maintain an effective Personnel Security and Suitability Program to ensure that the employment and retention of its personnel do not jeopardize or prevent the accomplishment of the agency's goals. The Federal regulations in 5 CFR parts 731 and 732 describes the criteria that federal agencies should use for establishing and maintaining an effective Personnel Security and Suitability Program. According to Executive Order 10450 and 5 CFR parts 731 and 732, an effective personnel security and suitability program includes performing background investigations on federal personnel. The level of background investigation is determined by the sensitivity designation of the position that the person occupies.

The five basic levels of background investigations include:

(1) National Agency Check (NAC) and Inquires (NACI) - Consists of an NAC, written inquires sent to employers, educational institutions, law enforcement, and references;

(2) Minimum Background Investigation (MBI) - Consists of a Personal Subject Interview (PRSI), basic NAC, credit search. Coverage is five years;

(3) Limited Background Investigation (LBI) - Consists of a PRSI, basic NAC including credit search, personal interviews with employment, residence, and educational sources, and law enforcement searches. Personnel coverage is three years and five years for record searches;

(4) Background Investigation (BI) - Consist of PRSI, basic NAC including credit search, personal interviews with employment, residence, and educational sources, and law enforcement searches. Total coverage is five years; and

(5) Single Scope Background Investigation (SBI) - Consist of PRSI, basic NAC including credit search, birth date verification, citizenship verification on subject and foreign-born immediate family members, spouse/cohabitant NAC, personal interviews with employment, residence, and educational

sources, and law enforcement and public record searches. Total coverage is 10 years.

On March 29, 1993, the United States Office of Personnel Management (USOPM) issued an appraisal of the FDIC'S Personnel Security and Suitability Program. The appraisal disclosed deficiencies in FDIC's Personnel Security and Suitability Programs. It was stated in the appraisal that 36 of the 164 (21%) FDIC personnel sampled did not have background investigations, and that 10 of the 36 (28%) were in positions designated critical sensitive. It is also stated in the appraisal that the FDIC has not adopted in whole or in part any of the recommendations from the USOPM appraisal performed in 1983.

In an effort to comply with the Executive Order 10450, 5 CFR Parts 731 and 732, and the USOPM recommendations, the former FDIC Office of Personnel Management (OPM) issued a memorandum on November 22, 1994 requesting that FDIC divisions and offices determine the sensitivity levels for each of its positions. The DOF responded to the OPM memorandum and designated supervisory positions over the assessment process as requiring minimum background investigations. The duties performed by DOF include processing assessments, one of the FDIC's major functions. The DOF billed, recorded and collected $2.5 billion in assessments and processed $1.5 billion in refunds during the July semiannual period. These processes use sensitive information including the institutions' risk classifications, and account and routing numbers. However, DOA has not verified the sensitivity designations or performed background investigations of DOF personnel.

DOA representatives informed the OIG that most FDIC personnel have not received background investigations because of the FDIC reorganization, downsizing, National Treasury Employees Union (NTEU) negotiations, and lack of detail position descriptions. According to DOA representatives, background investigations (with the exception of an NACI) cannot be performed on personnel in nonsupervisory positions due to the NTEU negotiations. However, DOA has started to review and determine which personnel in supervisory positions require background investigations beginning with DIRM. The completion of this project cannot be estimated at this time due to on-going NTEU negotiations, upcoming changes in 5 CFR Parts 731 and 732, and the on-going review of position sensitivity designations.

<u>RECOMMENDATION:</u> The lack of the background investigations subject FDIC to noncompliance with federal regulations as well as the risk of disclosure or manipulation of sensitive information. Therefore, the OIG recommends that DOA:

1) Determine the reasonableness of the DOF position sensitivity designations; and

2) Perform background investigations for personnel involved in the assessment process, who are not represented by the NTEU. Once there is agreement with the NTEU, personnel involved in the assessment process that are represented

by NTEU should have appropriate background investigations performed.

* * * AUDITEE RESPONSE * * *

When the Security Services Section (Section) was established as part of the Division of Administration's (DOA) Corporate Services Branch in September 1995, one of the units created as part of that Section was the Employee/ Contractor Security Unit. One of the major functions of that unit was to manage the Suitability and Adjudication Program as mandated under Executive Order 10450. Prior to that time this function fell under the responsibility of the Personnel Services Branch of DOA.

Upon assuming responsibility for this function, the Section discovered that the position sensitivity designations and required personnel suitability background investigations had not been completed. As such, one of the first priorities of the Employee/Contractor Security Unit was to complete this project. Unfortunately, due to a number of NTEU objections, continued FDIC reorganization and downsizing, the return of RTC employees, and lack of detailed position descriptions this project has been delayed. We are, however, committed to full completion of this project in order to bring FDIC into full compliance of Executive Order 10450.

Our action plan for completing this project given the conditions outlined above is as follows:

a. Working with each division and office, including DOF, assign a sensitivity designation for each classified position description;

b. Complete appropriate suitability background investigations on all non-bargaining unit employees;

c. Conduct necessary background investigations on all bargaining employees, once all NTEU issues have been resolved.

At this point, given the conditions outlined above and the fact that U.S. OPM is considering a number of changes related to background investigations, we cannot give you a time-phased plan. Our goal is to complete this project as rapidly as possible concentrating on high risk positions first and then moderate and low risk positions.

* * * OIG COMMENTS * * *

The OIG acknowledges the efforts planned by DOA to complete the appropriate suitability background investigations on all FDIC employees. The OIG also supports DOA's efforts of concentrating on high risk positions first and then moderate and low risk positions as quickly as possible.

V. **<u>Documenting the Verification of the Assessable Institution Universe</u>**

<u>CONDITION:</u> The verification of the assessable institution universe needs to be adequately documented. While our analysis indicated that the July 1, 1995 assessment universe was complete, the AOS had no documented evidence to confirm that the AIMS contained the complete universe of insured institutions. To verify that all insured institutions have been identified in AIMS, AOS management stated that they rely on automated two-way reconciliations between AIMS, RRPS, CALL and CALLSL. However, the automated two-way reconciliation capability was not developed and implemented.

The Structure database, administered by DOS, is the FDIC's official record of institutions. DIRM updates a data set of insured institutions in AIMS from Structure. A copy of the data set is given to FIRB for quality control tests purposes and to AOS as a record of the universe of institutions for which assessments are to be collected. AIMS uses the data received from Structure to obtain the risk classifications for insured institutions from the Risk Related Premium System (RRPS), and to obtain the financial information for the insured institutions from the Call and CallSL (Call(SL)) systems. To verify that AIMS contains all insured institutions, AOS management relies on automated two-way reconciliations between AIMS and the RRPS, Structure, and Call(SL) systems. During the development of AIMS, two-way reconciliations were discussed by DOF, but the two-way reconciliation capability was not developed and implemented. However, a one-way reconciliation is performed where AIMS prints exception reports for insured institutions for which AIMS is not able to locate risk or financial data in RRPS or Call(SL). AIMS does not print out exception reports for insured institutions appearing in the RRPS and Call(SL) systems, but missing in AIMS. In addition to the one way reconciliations, AOS and FIRB performed reconciliations between the Structure data sets received from DIRM. However, the AOS and FIRB reconciliations were not sufficient to

verify the successful update of all insured institutions from Structure into AIMS by DIRM since AOS and FIRB were reconciling the same file. Also, DIRM does not confirm the Structure universe with DOS when updating the AIMS universe.

The AOS management indicated that reconciliations outside of the automated process would be a time consuming burden. However, members of AOS performed independent reconciliations of the AIMS institution universe against Structure. The AOS indicated that no exceptions were discovered, but did not retain documentation of the reconciliations performed. Our analysis indicated that the July 1, 1995 assessment universe was complete.

<u>RECOMMENDATION</u>: To ensure that all insured institutions are assessed, the OIG recommends that the DOF document the verification that AIMS contains the complete

universe of assessable institutions. The DOF may implement and document the automated two-way reconciliation between AIMS, and the RRPS and Call(SL) systems. Alternatively, the DOF may document their independent reconciliation against Structure, or request DOS to provide a documented confirmation containing the number of insured institutions at the time of the Structure update into AIMS.

* * * AUDITEE RESPONSE * * *

The Assessment Operations Section will continue to independently verify and document that AIMS contains the complete universe of assessable institutions.

* * * OIG COMMENTS * * *

Documenting the verification that AIMS contains the complete universe supports the names and numbers of institutions assessed.

VI. Using Consistent Criteria for Risk Classifications

CONDITION: The DOS needs to ensure that risk classifications are consistently assigned to institutions using examination reports available as of the established dates. The DOS Director instructed the Regional Directors to use SAER data for examinations transmitted to the institutions as of established dates, while other primary federal regulators were instructed to provide the FDIC with tapes containing classifications using data available as of the same established dates. In addition, the DOS' RRPS is programmed to extract the examination results from the SAER database for examinations with reviews completed, but not necessarily transmitted, as of the date that RRPS interfaces with the SAER database. Our analysis of the institutions classified for the semiannual period beginning July 1995 determined that 357 FDIC regulated institutions received risk classifications based on SAER data reviewed and transmitted after the established date. Although not classified in compliance with the DOS Director's instructions, the FDIC regulated institutions were classified using examinations available in the Regional Offices as of the established date. Therefore, all institutions regulated by the FDIC and the other primary federal regulators were consistently classified as of the established date. However, controls are needed to ensure that risk classification are consistently assigned in future assessment periods.

The FDIC Rules and Regulations Section 327.4(a)(2) delegates the authority to set dates applicable for determining Supervisory Subgroup (SSG) assignments to the FDIC Director of Supervision. The supervisory rating is based upon examination reports contained in the SAER data base. In a memorandum dated April 3, 1995, the Director of Supervision instructed Regional Offices to use SAER data for examinations reviewed and transmitted to the institutions by March 31, 1995 for determining the July 1, 1995 SSG assignments. Except for institutions appearing on the Reconciliation Report, Regional Directors are instructed to use data transmitted after the established date, "sparingly." The FDIC instructed the other primary federal regulators, Comptroller of the Currency, Federal Reserve System and the Office of Thrift Supervision, to provide the FDIC with tapes containing supervisory ratings using data available as of March 31, 1995.

According to DIRM representatives, the RRPS is programmed to extract the SAER data as of the date RRPS interfaces with the SAER data base. As such, RRPS classified FDIC regulated institutions using SAER data for examinations which had been reviewed by the Regional Offices as of April 11, 1995, the date that RRPS interfaced with the and SAER data base. Our audit tests disclosed that 357 FDIC regulated institutions were assigned SSG risk classifications using the SAER data for examinations reviewed and transmitted after March 31, 1995. Four of the 357 FDIC regulated institutions had revisions in their SSG classification resulting from the new SAER data. Although not classified in compliance with the DOS Director's instructions, the four FDIC regulated institutions with revised SSGs were classified using examinations available in the Regional Offices as of the established date. Therefore, all institutions regulated by the FDIC and the other primary federal regulators were consistently classified as of the established date. During meetings, DOS management stated that the DOS Director's instructions should be modified to allow the use of FDIC examination reports received by the established date and reviewed by the RRPS and SAER interface date for classifying institutions.

RECOMMENDATION: After notifying DOS management of this issue, DOS requested that DIRM add examinations reviewed in the Regional Offices between the established date and the interface date to a reconciliation report. DOS will instruct the Regional Offices to consider whether the new or old examinations should be included in the classification of the institutions. To ensure the equitable assessment of financial institutions, the OIG recommends that the DOS:

1) Inform the Regional Offices that the SSG risk classifications assigned by the RRPS should be based on examinations received by the established dates and reviewed by the RRPS and SAER interface date;

2) Ensure that the modifications made by DIRM are functioning as requested; and

3) Implement procedures for the review of the institutions using SAER data after the established dates that appear on the reconciliation reports modified by

DIRM.

* * * AUDITEE RESPONSE * * *

DOS agrees to implement the recommendations.

* * * OIG COMMENTS * * *

The OIG appreciates DOS' desire to ensure that risk classifications are consistently assigned to institutions using examination reports available as of the established dates.

VII. Establishing Assessment Accounts Receivables

CONDITION: The assessment obligation and payment reports, and manual entries need evidence of approval signatures to support the establishment and removal of accounts receivables in the CARMS. The CARMS is a subsidiary system in which the ARU uses to record assessment receivables and receipts. During our audit period, assessment transactions totalling approximately $2.47 billion were processed through the CARMS, including approximately $71.2 million in adjustments. The journal entries we tested were recorded in the CARMS and transmitted to the GL correctly. However, the ARU in the DOF needs to maintain evidence of written approval for the entries in the CARMS.

In the DOF, the AOS performs tests to verify the assessment amounts in the obligation and payment files. The obligation file is a list of institutions to which AOS sends assessment invoices; and the payment file is a list of institutions expected to make assessment payments. The Assessment Information

Management System (AIMS) Final Invoicing Summary summarizes the data included in the obligation file and the Direct Debit processing Summary summarizes the data included in the payment file. The AOS provides these summaries to the ARU to enable ARU to verify amounts recorded in the CARMS. The AIMS interfaces with CARMS to establish a receivable for institutions included in the obligation file and to record a payment for the receivables included in the payment file. It is stated in the CARMS Manual that the assessment data is to be generated within AIMS and interfaced with CARMS, after the approval by AOS and the ARU management. However, the CARMS Manual does not require that the approval of these transactions be in writing.
In addition, ARU records four types of manual entries. The manual entries include:

(1) Sales - the establishment of a receivable,

(2) Cash - the receipt of cash payment,

(3) Adjustments - adjustments to entries recorded, and

(4) Nonmonetary maintenance.

Currently, ARU receives the manual entries and related supporting documentation from AOS and CMU. However, based on the audit tests performed on five manual entries, two manual entries had supporting documentation that were not signed by the originating office. While the OIG verified that the manual entries were proper and correct, an originating office's signature is needed to verify that the entry has been reviewed and approved.

The CARMS Manual does not require the originating office's written approval for manual entries recorded to CARMS. Without written approval, ARU has not received documented assurance that adjustments totaling approximately $71.2 million made to CARMS were proper and correct.

RECOMMENDATION: The ARU needs written approvals to ensure the proper and correct recording of assessments in future periods. To improve verification of the AIMS to CARMS interface and CARMS manual entries, the OIG recommends that the DOF management instruct the AOS:

1) To provide, and the ARU to require, an AIMS Final Invoice Summary and a Direct Debit Processing Final Invoice Summary signed by an AOS official with delegated authority over assessment transactions during to the interface between AIMS and CARMS; and

2) In concert with the CMU to provide ARU with assessment related manual entries signed by the appropriate AOS and CMU delegated authority.

* * * AUDITEE RESPONSE * * *

As of March 29, 1996, the Accounts Receivable Unit (ARU) has implemented the recommendations as requested by the OIG.

* * * OIG COMMENTS * * *

The OIG is please to be advised that the recommendations have been implemented.